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REPLY BRIEF FOR PETITIONER

In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 791

IRENEE du PONT, *Petitioner,*

v.

DAVID BURNET, *Commissioner of Internal Revenue*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit

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REPLY BRIEF FOR PETITIONER

I.

The Government relies on its brief in *Commissioner* v. *Wells,* No. 792, October Term, 1932, for its proposition that section 219(h) of the Revenue Acts of 1924 and 1926 is constitutional when applied to irrevocable trusts. We believe that we have fully answered the Government's arguments in our brief for the respondent in that case as well as in our principal brief for the petitioner in this case.

II.

Unquestionably the settlor retained a reversion (contingent upon his survival) in the corpus of the trust funds. The Government's contention under point II amounts to saying that Congress, if it chooses, may constitutionally tax the income of property to any holder of a future estate therein. The Government's argument under this point is not based on any suggestion that a man can be taxed on the income from property because he once owned the property, but goes to the other extreme and says that he may be taxed on the income of property if he will eventually (on the happening of certain contingencies) own the property. If this be sound, then in case of a limitation to A for life, to B for life, to C in fee provided he survives A and B, otherwise to the heirs of B, Congress would be at liberty, if it saw fit, to tax to C the income received by and held for their own uses by A and B during their lives.

It is true, as said in ***Reinecke*** v. ***Smith,*** (April 10, 1933), that the same considerations as to ownership and control affect the power to impose the tax on the transfer of the corpus and upon the income—in that if there is no power to tax the corpus as a part of a man's estate, there is no power to tax the income from that corpus to that man.

But we submit that this court never intended in ***Reinecke*** v. ***Smith,*** to intimate that because a man had a remote contingent interest in property, which might be taxable as part of his estate, that gave Congress the power to tax all the income from such property to him

prior to the time when he could touch or control the property in any way.

If a conveyance were made to B for the life of A with a power of appointment in A to be effective upon his death, under the authorities the property over which A has power of appointment would be taxable as part of his estate. But the thought that A could be taxed during his life on the income received by B from the property shocks all sense of justice.

The Government says (p. 12):

> "The transfer would also be taxable under the rule applied to revocable trusts in *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339. The only difference between the cases is that there the power to revoke was continuous while here it was periodically recurring—a difference in control which, we believe, is not sufficient to require different results."

The only difference between the cases is the same difference that exists between a term for years and a term at will.

Before the effective date of the Revenue Act of 1924, Mr. du Pont had put it wholly beyond his power to touch, at any time during the calendar years 1924 and 1925, any of the income from the trust funds. He could not subject the income to the tax, nor could he until December 18, 1926 touch the corpus.

This is entirely different from the situation that would have existed if he could have revoked the trusts and used the 1924 income to pay the 1924 tax and the 1925 income to pay the 1925 tax.

He could not even use the 1926 income to pay the

1926 tax, except a very small fraction of it. If the income is presumed to have accrued ratably,[1] he might have subjected to his own use that part accruing in the last thirteen days of the year—13/365ths, or slightly over 3.6%—which would not have helped very much toward the 20% surtax the Government is attempting to collect from him for 1926.

We submit that certainly until December 18, 1926 Mr. du Pont was not, and could not have made himself, the owner of the income or the corpus, and that no income accrued prior to that date can be taxable to him.

When income accrues while the property is owned by one person but is reduced to possession after title has passed to another, Congress may tax that income to the man who owns the property while it accrues—for undoubtedly Congress could levy an income tax under which everybody was required to make returns on an accrual basis, or Congress could tax it to the one who actually received it, as in *Taft* v. *Bowers,* 278 U. S. 470; *Newman, Saunders & Co.* v. *United States,* 36 Fed. (2d) 1009; *Osburn California Corp.* v. *Welch,* 39 Fed. (2d) 41, etc. But, we submit, Congress could not tax to the first owner income which accrued to the second owner and which was received by him, nor could it tax to the second owner income which had actually been received and retained by the first owner and which the second owner could not apply in payment of the tax.

The suggestion of the Government that the taxpayer might render himself immune from taxation by estab-

[1] *Rouss* v. *Bowers,* 30 F (2d) 628, cert. den. 279 U. S. 853.

lishment of trusts renewable from year to year or month to month is probably true. However, analysis of the suggestion of the Government does not startle one to the extent that is inferred by their statement. Suppose A has a 6% $1,000 coupon bond with interest payable semi-annually on January 1st and July 1st. On December 31st of a given year he places the bond in trust for a period of two days, the income of the trust to be payable to his wife. If A were on the accrual basis all but one day of the interest that had accrued since July 1st would be taxable to him and that one day's interest would be taxable to his wife. If A were on the cash receipt basis it is true that he would not, under the present revenue acts, be taxable on the six month's interest but this is because the revenue act allows him to make his return on a cash receipt basis. As suggested above, Congress could require him to report his income on the accrual basis. Consequently, the remedy for the situation propounded by the Government is legislative and not judicial. But if A were on the accrual basis or were required to report his income on the accrual basis, it is submitted that as to one day's interest he could not constitutionally be taxed thereon. By his irrevocable trust of December 31st he parted with all right, title, interest and control over that one day's interest and he could not use that one day's interest income *to pay the tax that would be based on it.*[1]

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[1] The entire interest income could be taxed to A's wife because she received it. *Taft* v. *Bowers*, 278 U. S. 470. In fact, if A were on the cash receipt and disbursement basis such would be the result under the various revenue acts. Cf. *New York Trust Company, Trustee*, — B. T. A. —, promulgated April 10, 1933. (C. C. H. Dec. No. 7998)

We submit that no matter whether a trust is irrevocable for a day, a month, a year, a lifetime, or forever, there is a constitutional prohibition against taxing to the settlor any income to which he has no title, over which he has no control, if derived from property over which he had no control when the income accrued and was realized.

One of the cases relied on by the Government is *Rosenwald* v. *Commissioner,* 33 Fed. (2d) 423, certiorari denied 280 U. S. 599. In that case the Circuit Court of Appeals for the Seventh Circuit said:

> "Petitioner's chief contention is that there was a completed gift, and that petitioner never received the income.
>
> "It is doubtful whether a holder of securities may separate the income thereafter to accrue from the principal, and make a gift by way of assignment of the income, **without assigning or trusteeing the thing out of which the income arises,** where the effect would be to relieve the donor from a tax he would otherwise be required to pay. **We hold, however, that the delivery to the fund of the negotiable Third Liberty Loan bond coupons, before their maturity, made a completed gift, and that the coupons are not taxable as income as against petitioner.** (Emphasis supplied.)
>
> "* * * If, in the instant case, it must be said that what petitioner did was to give the principal and income therefrom for a period of five years, then, clearly, it seems to us that, as the principal was represented by the stock certificates, the Gimbel note, the lease, and the bonds, there was no reason

why the things assigned could not have been delivered. They could have been delivered to the fund or to a trustee to be held for five years for the purposes of the assignment."

In the case at bar, Mr. du Pont did exactly the things which Mr. Rosenwald had failed to do. He assigned and trusteed the thing out of which the income arose and delivered the stock certificates to the trustee to be held for the period of the trusts.

The Government's attempt (pp. 13-14) to distinguish our citations of cases holding that "income should be taxed to the holder of the present estate rather than to the holder of the future estate" on the ground that those cases were concerned with construction rather than constitutionality of statutes, amounts to an argument that it would be constitutional for Congress to tax the income of a present estate to the holder of a remainder or reversion.

III.

The Government now attempts to justify the tax for 1926 under section 219(g) of the Revenue Act of 1926. This point was not made below, either in the Board of Tax Appeals or in the Circuit Court of Appeals, and the burden should be on the Government to show from the record that the facts on which it relies are true. The record does not show that "It was within the power of the petitioner to revest in himself title to the entire corpus of the trust property during the year 1926." In the light of the language of section 219(g) of the Revenue Act of 1924, the settlor may very

well have decided before the beginning of 1926 to divest himself of the power to terminate the trust and resume title to the corpus during that year.

If the taxpayer did not have the power during 1926 to resume the ownership of the corpus, the income cannot be taxed to him under section 219(g). *Langley* v. *Commissioner*, 61 F. (2d) 796, (C. C. A-2); *Lewis* v. *White*, 56 F. (2d) 390, D. C. Mass., Appeal to C. C. A.-1 dismissed Oct. 21, 1932; *Ashforth Est.*, 26 B. T. A. 1188. If the Government had made the point of section 219(g) in the determination of the Commissioner or before the Board of Tax Appeals, the taxpayer might have been able to show that the trust was extended before the beginning of 1926. But there was no reason why it should have shown that under the Commissioner's determination or the pleadings before the Board, and if the Government now wants to raise the new point it should undertake to show where in the record it appears that the petitioner did in 1926 have the power to revest the trust property in himself.

However, we submit that if we are right in our contention that the ownership of a reversion does not render a man taxable on the income from property which he cannot subject to his own uses, and that Congress cannot tax a man on the income of property of which he has made a gift, it follows, as shown in Point VI of our brief in chief, that the extension of the trust was equivalent to the making of a new gift, the making of which might be subjected to a gift tax,[1] but which

[1] It would have been taxable under the gift tax provisions of the Revenue Act of 1924 or under the gift tax provisions of the Revenue Act of 1932, if it had been made during the effective term of either of those Acts.

would render the income of the transferred property taxable only to the transferee during the term for which the transfer was made.

Respectfully submitted,

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